

Date of Hearing: May 16, 2019

ASSEMBLY COMMITTEE ON APPROPRIATIONS

Lorena Gonzalez, Chair
AB 5 (Gonzalez) – As Amended May 1, 2019

Policy Committee: Labor and Employment

Vote: 5 - 0

Urgency: No

State Mandated Local Program: Yes

Reimbursable: No

SUMMARY:

This bill clarifies the determination of whether a worker is an employee. Specifically, this bill:

- 1) Codifies the decision of the California Supreme Court in *Dynamex Operations West, Inc. v. Superior Court of Los Angeles* (Dynamex) that presumes a worker is an employee unless a hiring entity satisfies a three-factor test (ABC test).
- 2) Applies the ABC test to the Labor Code and Unemployment Insurance Code (UIC) for instances when a definition of employee is not otherwise provided.
- 3) Exempts specified occupations from the application of ABC test and instead applies, for these occupations, the definition of an employee set forth in *S. G. Borello & Sons, Inc. v. Department of Industrial Relations* (Borello).

FISCAL EFFECT:

There is considerable uncertainty around the fiscal impact of this bill. Widespread adoption of the ABC test will, relative to current law, likely lead to more workers classified as employees rather than independent contractors. This will generate additional workload and costs for the Department of Industrial Relations (DIR) and the Employment Development Department (EDD), though costs would be partially offset by a simpler process to determine a worker's classification.

Moreover, as drafted, it is unclear how broadly the ABC test will be applied under this bill. This committee assumes the bill's fiscal impact is primarily related to DIR and enforcement of the Labor Code. (For a discussion of possible EDD costs, please refer to Staff Comment #4.) Costs to DIR's Division of Labor Standards Enforcement (DLSE) will be \$840,000 in the first year and \$800,000 each year thereafter, and there will be an unknown fiscal impact on DIR's Department of Workers' Compensation (DWC). These costs reflect the costs of additional legal staff and the costs of preparing and updating guidance for the public and staff.

COMMENTS:

- 1) **Worker classification tests.** The determination of whether a worker is an employee is typically a test that evaluates the nature of the employer's relationship with the worker. In California's labor law context, the discussion generally revolves around two types of tests:

- a) **Borello test.** The Borello test involves the principal factor of “whether the person to whom services is rendered has the right to control the manner and means of accomplishing the result desired” and also includes the following nine additional factors:
- (1) right to discharge at will, without cause; (2) whether the one performing the services is engaged in a distinct occupation or business; (3) the kind of occupation, with reference to whether in the locality the work is usually done under the direction of the principal or by a specialist without supervision; (4) the skill required in the particular occupation; (5) whether the principal or the worker supplies the instrumentalities, tools, and the place of work for the person doing the work; (6) the length of time for which the services are to be performed; (7) method of payment, whether by the time or by the job; (8) whether or not the work is part of the regular business of the principal; and (9) whether or not the parties believe they are creating the relationship of employer-employee.
- b) **The ABC test.** The ABC test is much more simple (and actually predates the Borello test). The determination of a worker’s classification rests on these three prongs: (A) The worker is free from the control and direction of the hirer in connection with the performance of the work, both under the contract for the performance of such work and in fact; (B) the worker performs work that is outside the usual course of the hiring entity’s business; and (C) The worker is customarily engaged in an independently established trade, occupation, or business of the same nature as the work performed for the hiring entity.
- 2) **Dynamex.** The State Supreme Court, in its Dynamex ruling, concluded that certain package delivery drivers were misclassified as independent contractors rather than employees under a California wage order specific to the transportation industry. The court adopted the ABC test and rejected the Borello test, in part, on the grounds the test was not appropriate for wage and hour laws whose purpose is to protect workers.
- 3) **Recent DIR letter.** On May 3, 2019, DIR released a letter clarifying its application of the ABC test. The letter concludes that to “the extent that the claims rest on the ‘failure to fulfill obligations imposed by’ an applicable Industrial Welfare Commission (IWC) wage order, the ABC test applies.” The letter further elaborates the test will also apply to “obligations imposed by a wage order,” which applies to Labor Code sections enforcing wage orders. As an example, DIR cites LC Section 203, which imposes a penalty for wages not paid at the time of termination of employment. DIR notes that where this section serves to enforce the underlying minimum wage obligations of the wage orders, application of the ABC test would be appropriate.
- 4) **Staff comment on EDD costs.** The author recently amended this bill to extend the application of the ABC test to the UIC in cases where another definition of employee is not otherwise provided. However, it is unclear what instances this would apply to since UIC Section 621 defines an employee as an individual who is an employee as applied by common law rules. It is the committee’s understanding that the author intends to apply the ABC test more broadly to the UIC. In that case, the state costs with this proposal would increase significantly. Specifically:

- a) Significant administrative workload and costs – possibly in excess of \$1 million – for the Employment Development Department (EDD) to develop regulations and update materials and guidelines. While typically EDD can promulgate regulations within existing resources, this bill may require additional attorneys and staff, which could increase personnel costs by approximately \$350,000. Moreover, EDD would need to conduct a significant review and update of the guidance and information it provides employers and employees related to employment determination, which will create significant new costs of an unknown amount.
- b) Unknown costs to state programs because of a possible shift in the reclassification of workers. EDD currently applies a range of factors when determining whether a worker is an employee or independent contractor. It is likely that the ABC test, in many cases, will yield the same determination as EDD's current standard. However, on net, there may be more workers classified as employees compared to EDD's current practice. If more workers are classified as employees because of this bill, there could be increased revenues into, and expenditures from, the Disability Insurance (DI) Fund, which supports the State Disability Insurance Program and the Paid Family Leave Program, and the Unemployment Insurance (UI) Fund, which supports unemployment benefits.

Analysis Prepared by: Luke Reidenbach / APPR. / (916) 319-2081